

May 13, 1997

**By UPS**

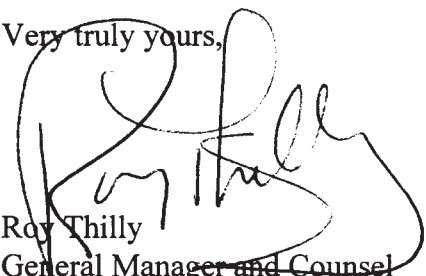
The Honorable John D. Dingell, Ranking Member  
Commerce Committee Democratic Office  
564 Ford House Office Building  
U. S. House of Representatives  
Washington, DC 20515

Dear Congressman Dingell:

Enclosed is WPPI's response to your April 10, 1997 letter. I apologize that this response is a few days late. Like all utilities in Wisconsin, our top priority for the last several weeks has been preparing for potential electric shortages and related reliability problems this spring and summer. Almost all of our ongoing projects have been put on the back burner to address these matters and this, unfortunately, has resulted in a delay in our response to you.

Thank you again for asking for our views on important electric restructuring matters.

Very truly yours,



Roy Thilly  
General Manager and Counsel

Enclosures

cc: Deborah Sliz, APCO Associates  
Joe Nipper, APPA

CONGRESS/DINGELL.CVR

May 13, 1997

By UPS

The Honorable John D. Dingell, Ranking Member  
Commerce Committee Democratic Office  
564 Ford House Office Building  
U. S. House of Representatives  
Washington, DC 20515

RE: Federal Electric Restructuring Legislation

Dear Congressman Dingell:

I am writing in response to your letter of April 10, 1997 asking for answers to a number of questions concerning possible legislation to restructure electric utility industry. Thank you very much for including The Wisconsin Public Power Inc. SYSTEM (WPPI) on the list of public power entities from which you have solicited comment.

WPPI is a municipal electric joint action agency owned by 30 Wisconsin cities and villages that operate electric distribution utilities. WPPI was created in order to give municipal utilities more control over their power supply and to promote competition at wholesale. WPPI supplies all of its members requirements under long-term, all-requirements power supply agreements. The revenues under these agreements have been pledged to secure debt issued finance construction and acquisition of generation. WPPI owns a 20 percent interest in a 535 megawatt coal-fired plant (Boswell 4) operated by Minnesota Power and Light Company and two new 86 megawatt combustion turbines located in Wisconsin. Our total load is approximately 600 megawatts. WPPI purchases approximately more than one-half of the requirements of its members at wholesale from other utilities and marketers. We operate a 24-hour scheduling center and are full members of the MAIN and MAPP Reliability Councils.

WPPI has been an active proponent of open access transmission for many years. We own no transmission and operate in four investor-owned utility control areas. Our major generation -- Boswell 4 -- is remote from our load. For this reason, WPPI was a founder of the Transmission Access Policy Study group (TAPS) and through TAPS has fought hard for equal access and the development of vigorously competitive regional bulk power markets. We believe that all utilities and their customers will benefit from vigorous competition at wholesale. Retail regulation ensures that all classes of retail customers -- residential, commercial and industrial -- receive a fair share of these benefits.

The remainder of this letter responds to the four questions set forth in your letter of April 10.

**1. What are your biggest concerns about retail competition? If retail competition has already been adopted by the state(s) you serve, or is under active consideration, what position have you taken and why?**

**A. Status of retail competition in Wisconsin.**

The Public Service Commission of Wisconsin is currently engaged in a 32-step process to examine and implement changes in electric utility regulation and industry structure that will benefit all Wisconsin consumers. This process includes fostering vigorous competition in wholesale markets, restructuring the transmission function into an independent, regional independent grid, fostering vigorous competition in the construction of new generation, streamlining our state's advance planning process for new transmission and generation and unbundling retail rates to provide customers with better cost information and more service choices. The 32-step plan also includes accomplishment of a number of prerequisites necessary in the Commission's view to any implementation of retail competition and a determination in 1999 as to whether the Commission will recommend statutory changes to the Wisconsin Legislature that would permit retail competition in our state. That recommendation is to be made based upon success in achieving essential prerequisites and a determination by the Commission that retail competition can be implemented in a manner that will benefit all types of customers. Because of the Commission's examination of these issues, there is no legislation pending in Wisconsin on these issues at this time.

**B. WPPI's position in the Wisconsin debate.**

WPPI has been a very active participant in the policy debate that led to the PSC's 32-step plan and in various dockets that have now been implemented under that plan. WPPI is part of the Customers First! coalition, which includes other municipal utilities, the state's rural electric cooperatives, Madison Gas and Electric Company, the Citizens' Utility Board, the National Federation of Independent Businesses, the Environmental Decade, RENEW Wisconsin, AARP and a variety of other public interest and consumer groups. These groups developed and proposed the "Sequential Approach to Restructuring" that was filed with the PSC in an Advisory Committee process that preceded the Commission's decision to adopt the 32-step plan. A copy of the Sequential Approach is enclosed for your reference. The 32-step plan is generally consistent with the Sequential Approach. The primary purpose of the Approach is to preserve the benefits of Wisconsin's low rates, customer satisfaction and high reliability, while introducing competition into various elements of the industry where feasible and where all consumers will benefit.

**C. WPPI's concerns.**

WPPI's principle concern about retail competition is that consumers will not, in fact, realize the purported benefits of restructuring unless and until Congress and the states make fundamental changes to the current structure of the electric utility industry. Fundamental restructuring must precede retail competition if low-cost states like Wisconsin can hope to create a vigorously competitive retail market. The decision of whether or not to introduce retail competition cannot be disconnected from the need to simultaneously dismantle the existing regime of vertically integrated monopolies.

The fundamental policy question is whether retail competition can be implemented in a way that will result in lower electric costs for all types of customers, while preserving or enhancing reliability of service. In making this important judgement, policymakers must recognize that electricity is an essential service for many consumers, including businesses, and not just another commodity. Reliable, low-cost electricity is essential to public health and safety and to our state's economic well-being. WPPI believes that it is particularly important that small customers, including low-income customers, benefit from any changes in regulation and structure that are approved. We have yet to see mechanisms that assure us that this will, in fact, occur with retail competition.

WPPI is extremely concerned that hasty deregulation at the urging of our state's major private utilities will result in deregulated monopolies, not vigorous competition. This, in turn, will lead to higher prices and lesser reliability for most customers over the long-term. A key issue is whether Congress, our state Legislature and our Commission will have the political will to require that the prerequisites to retail competition set forth below are met and the industry is fundamentally restructured. If they do not, restructuring will fail. These prerequisites include:

▼ **Complete separation of control and operation of transmission from ownership and control of generation.**

This prerequisite requires the development of a regional transmission grid that is controlled, operated, planned and constructed as a single-system by an entity that has no interest whatsoever in generation or retail services markets. Transmission is the essential infrastructure for a competitive market. There are numerous ways in which transmission service, operation, maintenance, planning and construction can be manipulated for the competitive advantage of a generation owner. For this reason, complete separation is essential.

WPPI believes that divestiture of transmission assets by current owners to a regional transmission company is the best way to achieve this prerequisite. However, we support the formation of strong, truly independent system operators (ISOs) as a mechanism that may accomplish this prerequisite. If ISOs do not, in fact, result in the functional equivalent of divestiture, actual divestiture will be necessary. Enclosed is a detailed ISO proposal that has been prepared by WPPI, working together with residential, small business and large industrial customers in Wisconsin.

The ISO must have the ability to construct new transmission, so that existing bottlenecks are eliminated. Current transmission owners have little incentive to cure our transmission problems since the cure would open up their load to significant competition and them to the possibility of lost revenues. We believe that the major Wisconsin utilities are ardent advocates of retail competition today because they know that most potential competitors will not be able to reach most of their customers on a reliable basis. This fact would provide them with significant captive load on a continuing basis, without the constraints of rate regulation and, at the same time, deregulation would free them to compete for new load in the much higher cost (and profit) Illinois market.

The potential danger of the movement to create ISOs is that structures that are not truly independent and will leave owners with significant residual control and leverage will be accepted by regulators and will create the illusion, but not the reality, of eliminating the transmission market power problem. For this reason, WPPI believes that any federal restructuring legislation should give FERC not only the clear authority to mandate regional ISOs, but also the power to require divestiture if utilities are unwilling to place their facilities under the control of a strong, independent ISO or, if for some reason, an ISO does not work to truly eliminate transmission market power.

▼ **Elimination of opportunities to exercise generation market power.**

For retail competition to work, there will need to be many competitors in the regional generation market and all customers must have equal, reliable access to these competitors. WPPI is very concerned that the large utilities in our state will be able to exercise generation market power in a deregulated environment. Enclosed for your reference is a handout we have prepared on the specific market power problems that confront eastern Wisconsin. We believe that similar situations exist in other areas of the country.

Put simply, eastern Wisconsin, where most of Wisconsin's load is located, is very poorly situated for development of a competitive market. Eastern Wisconsin is an electric island with almost all the generation controlled by a few large utilities and very limited access to out-of-state suppliers. This region has access to electricity from other states in only two directions because of Lake Superior to the north and Lake Michigan to the east. Under normal circumstances, our access to cheaper energy from the west is severely constrained due to physical transmission limitations and our access to the south, which is solely through Commonwealth Edison Company, is also limited. This means that most customers in eastern Wisconsin must obtain their energy from generation located in eastern Wisconsin much of the time. Since a large number of the baseload units in eastern Wisconsin are jointly owned by the major utilities, and there are few owners in any event. This market is highly concentrated.

This problem is being illustrated dramatically today by the numerous nuclear plant outages being experienced in Wisconsin and Illinois. Wisconsin faces very serious reliability problems this summer and the nuclear outages have further reduced our limited access to the south and west significantly. This situation demonstrates vividly that Wisconsin does not have sufficient transmission capacity for reliability purposes, let alone to support vigorously competitive wholesale or retail markets.

For this reason, the construction of new major transmission interconnections with other states is essential to the creation of a competitive market. Without construction, very significant generation market power will exist. This construction must be addressed on a regional basis, because a number of the facilities that limit Wisconsin's transmission capacity are located in other states. The problem is made more complex because some fixes simply move the problem elsewhere.

A related generation market power issue is identification and treatment of "must run" units in a deregulated market. A number of generating units located in our state must be run in order to maintain voltage and keep transmission capacity open over crucial interfaces. Ownership of these "must run" units will confer market power. For this reason, divestiture of some generation, together with development of a market structure that protects consumers with respect to the output of "must run" units must be developed. No one has come forward with a good proposal on these issues to date.



A related step to addressing this problem is the need to prohibit the dominant utilities and their affiliates from constructing any new generation in the state until viable IPP competitors exist. There is only one bona fide IPP unit in Wisconsin today and the output of its unit is under contract to one of the major utilities for the long-term. This means that the unit is controlled by the utility and is not an independent competitor. If the state wishes to create a competitive generation market, it must not only examine divestiture of existing units, but promote the construction of new units by independent competitors through competitive bidding.

The market power prerequisite calls for much tougher standards for reviewing proposed mergers. WPPI is very concerned that the current trend to massive consolidation through mergers and other alliances and the creation of new interstate holding companies will end up defeating the objective of creating a competitive market. Mergers are a strategy to deal with the threat of competition by gaining market power. If we deregulate and end up with just a few entities controlling most of the regional generation, we will have done a tremendous disservice to the ratepayers.

In this regard, WPPI believes that states will not be able to resolve market power problems effectively. Therefore, federal legislation must contain new strong mechanisms to make sure markets are truly competitive and that we do not return to problems of the 1920s and 1930s.

Finally, the ISO, or independent transmission company structure, is essential to deal with generation market power on an ongoing basis. The ISO, or regional transmission company, must have the authority to require redispatch of generation and to prevent manipulation of available transmission capacity through a generation owner's order of dispatch. Similarly, the ISO, or independent transmission company, must provide neutral control area and ancillary services to all market participants.

▼ **Prohibition of affiliate abuses.**

WPPI is very concerned that today's vertically integrated monopolies intend to continue operating after deregulation at each level through affiliates. This plan will create the illusion, but not the reality, of the disintegration of vertically integrated utilities. Many of the advantages these companies have because they have been state-sanctioned monopolies will be carried forward if

they are permitted to continue to be vertically integrated through affiliate structures. Operations through affiliates create significant opportunities for regulated functions to subsidize non-regulated functions through the complex web of affiliate transactions. As you know, the Securities and Exchange Commission has been extremely reluctant to exercise its powers under the Public Utility Holding Company Act in this area for registered holding companies. We believe that regulators always will have a very difficult time penetrating and effectively dealing with affiliated abuse. In dealing with this prerequisite, WPPI believes that some transactions between regulated and non-regulated affiliates in the electric industry should be prohibited, at least until many robust independent competitors have been created.

▼ **Establishment of fair mechanisms to deal with bona fide stranded costs.**

WPPI believes that bona fide stranded costs prudently incurred due to a legal obligation to provide service should be recovered from the retail customers on whose behalf they were incurred, through distribution line charges, not through transmission charges. In Wisconsin, however, we are very concerned that existing coal generation will have a value significantly above cost in an open market. This gain should be an offset to any claims of stranded cost. Furthermore, the existence of this valuable generation raises the important question that if the market is opened up, and stranded cost offsets do not exist, who -- shareholders or former captive ratepayers -- should be entitled to capture the difference between market value and cost? This coal-fired generation has been in rate base for many years and ratepayers have borne construction risk associated with it and paid depreciation expense for it. For these reasons, Wisconsin ratepayers should have first call on continued service from this generation on a cost-of-service basis.

▼ **Reliability must be preserved.**

This key prerequisite requires that a structure be in place to sustain reliability of service at current levels or enhance it for all customers. WPPI is very concerned that in shifting from a paradigm of mutual cooperation and back-up to one of competition, reliability will suffer significantly. We have already noticed a decline in information sharing among utilities for competitive purposes and increased reluctance by utilities to help their neighbors. We believe these trends will harm reliability.

Some utilities assert that generation reserve margins must decrease substantially in a competitive market. We are very concerned that any reduction in reserve margins will result in less reliable service to customers over the long-term. Other important reliability issues include whether the cost-cutting and the



down-sizing that is occurring in preparation for competition will result in more outages and longer response times for restoration of service. We believe that this is the inevitable result of the cuts in preventative maintenance for generators and cuts in distribution protection activities like tree trimming that are occurring.

If the result of the drive for competition is poorer service, we will have done a major disservice to all consumers. Moreover, any projected savings from retail competition will quickly erode if electric service becomes more unreliable and more frequent outages occur. If customers end up having to pay a premium for the reliability they take for granted today, they will be very unhappy.

In order to address this prerequisite, enforceable and clear service standards must be adopted and reliability incentives and penalties must be in place, so that distribution customer service is not short-changed.

Most importantly, the current structure of NERC and its regional reliability councils must be dramatically reformed. This structure is controlled by large, vertically-integrated utilities and can be used for anti-competitive purposes. Reliability requirements must be uniformly applicable, mandatory and enforceable. They must be put in place, administered and enforced by a competitively neutral entity that has no stake in the generation and retail services markets. Furthermore, reliability standards and their enforcement must be non-discriminatory and reasonable and there must be a fair and neutral forum to resolve disputes.

WPPI is extremely concerned that large utilities may use their control of reliability councils to favor their own resources and discriminate against competitors. In this regard, enclosed is a copy of a letter which we recently sent to the Public Service Commission of Wisconsin complaining about a particularly upsetting example of this problem. Fortunately, FERC staff has intervened in support of WPPI to help resolve this issue voluntarily and the utilities involved are in the process of agreeing to procedures that would protect our resources on a comparable basis.

▼ **Adopt regional policies for restructuring.**

If retail competition is permitted, there must be a vibrant retail market that goes beyond state boundaries. For this reason, restructuring must be done on a consistent regional basis and reciprocity agreements must be put in place.

▼ **Protection of the environment.**

WPPI shares the concern of many environmentalists that deregulation and retail competition will result in degradation of the environment for a number of reasons. Mechanisms must be put in place to prevent this result.

First, we believe that unless public benefits protection mechanisms are in place the development of new renewable energy resources will be retarded and energy conservation and efficiency initiatives will receive much less funding for the short- and intermediate-term. This will increase our reliance on fossil fuel generation to the detriment of the environment. We also are very concerned that deregulation will result in increased emissions and that environmental protection will fall to a lowest regional common denominator.

▼ **Protection of universal service and low-income customers.**

WPPI is very skeptical that there will be vigorous competition to serve low-income customers, let alone residential customers in general. Mechanisms must be in place to ensure that electricity as an essential service remains a universal service and low-income customers have access to adequate supplies of electricity at reasonable cost. This will require not only fostering retail aggregators, including preservation of nonprofit alternatives such as municipal utilities and cooperatives, but also creating fair funding mechanisms for low-income energy assistance and low-income energy weatherization and developing means to prevent disconnects that threaten health and safety.

As this discussion of prerequisites demonstrates, the creation of a competitive retail electricity market that preserves the public interest will be very difficult. We believe that this objective is capable of accomplishment, but we are not certain that the ultimate benefits will outweigh the costs, particularly for a low-cost state like Wisconsin. The risk that deregulation will result in higher electric cost, lower reliability and significant cost shifts to residential and small business customers is very considerable.

**2. Do you believe Congress should enact legislation mandating retail competition by a date certain and why, or why not?**

We oppose federal legislation that would mandate retail competition by a date certain. We believe that the circumstances in different states are very different, particularly between high-cost and low-cost states. Regulation of retail electric service is an area of traditional state concern and authority. We see no valid reason why this responsibility should be shifted to the federal government at this time. In light of the complex issues described above, we believe that the citizens of Wisconsin should determine whether a change in their existing regulatory structure should be made or not.

May 13, 1997

Page Ten.

We also believe that federal legislation should facilitate any state decisions to implement retail competition. Without federal legislation, state initiatives are likely to fail. States generally lack the authority to restructure transmission through development of regional single-system grids and to force the creation of truly independent ISOs or mandate divestiture. It is equally unclear how states will be able to deal effectively with generation market power and affiliate abuse issues involving large multi-state companies.

**3. Some privately owned utilities assert that public power enjoys a broad range of tax-related and other advantages, which independently-owned utilities (IOUs) do not, and that these would unfairly benefit public power in a competitive retail market place. Do you agree? Do IOUs enjoy any benefits public power does not?**

This question addresses the predictable “level playing field” argument frequently raised by private utilities to disparage public power systems and discount our lower rates. Every time I hear this argument, I see the Green Bay Packers playing our local high school on a perfectly level field and envision the inevitable carnage.

As you know, investor-owned utilities enjoy a variety of tax benefits, including in particular, the collection of deferred taxes from ratepayers that substantially exceed actual tax payments. In 1993 alone, subsidies to private utilities in the form of accelerated depreciation, investment tax credits and deferred taxes cost the Federal treasury and U. S. taxpayers almost \$11 billion. Enclosed for your review is a study by Mr. Keith Wilkins that discusses the tax benefits received by investor-owned utilities.

Whatever net tax benefits the public power sector may have are equaled or outweighed by the economies of scale and scope achieved by the large investor-owned utilities and the tax deductions and other tax benefits they receive. In this regard, we would point out that WPPI makes payments in-lieu-of taxes to the state on its generation and each of its members makes payments in-lieu-of taxes to its municipal government and is often the largest taxpayer in the community. Payments also are made to the state by Wisconsin municipal utilities for service outside of municipal boundaries.

**4. If Congress were to mandate retail competition, please provide any recommendations you have on the following issues:**

**A. Stranded Investment. How should utilities’ stranded investment be treated? Does your company face anything similar and, if so, how should it be treated?**

WPPI supports the recovery of reasonable net stranded investment costs for utilities that have constructed generation prudently pursuant to a legal obligation to provide service at retail. We believe that stranded costs must be netted against benefits

from plants that may have a value which is above cost in an open market and we would limit recovery to actual, verifiable stranded investment costs. We oppose securitization of stranded investment costs that simply provides a rate decrease now for political purposes and imposes higher rates on customers in the future than would otherwise occur.

WPPI's resources are generally competitive and we are a low-cost supplier. However, we face the possibility of stranded costs because of IRS private use restrictions on facilities financed with tax-exempt debt. As we understand these restrictions, WPPI and its members cannot enter into fixed rate contracts with customers where the power will come from facilities financed with tax-exempt debt. Under retail competition, we will all have to shift from tariff service to contract service for customers. If WPPI and its members are unable to enter into contracts with industrial and other customers that guarantee them a fixed price, we will be at a very significant competitive disadvantage. At the same time, the private use restrictions will undermine our ability to mitigate the loss of any retail load through selling our freed-up capacity to other utilities and marketers on the wholesale market.

If retail competition is to be permitted, it is essential that IRS private use restrictions be lifted on existing generation and transmission in order to prevent public power systems from incurring substantial new stranded costs and to enable them to compete vigorously in new markets. Retaining private use restrictions on generation and transmission in a restructured electric industry will permanently shift the "level playing field" in favor of private utilities and ensure WPPI and other public power systems cannot compete in new markets. We believe the private use restrictions can continue for any new generation, since a public power system will be able to choose whether to take the risk of those restrictions or not when it makes its decision to construct. However, no private use restrictions should apply to existing or new transmission facilities to which an open access tariff applies. In this regard, WPPI believes that the transmission facilities of public power systems should be open and independently operated on the same basis as the facilities of private utilities.

**B.     Reciprocity. Should Congress consider provisions barring access to markets in states which have adopted retail competition by generators and states which have not? Which interests would this affect, and how?**

We would not support legislation by Congress that would bar access to markets in states that have adopted retail competition by generators in states which have not. If retail competition is authorized by a state, we believe that customers will benefit only if all competitors have access to that market. At the same time, we support regional coordination on addressing restructuring issues.

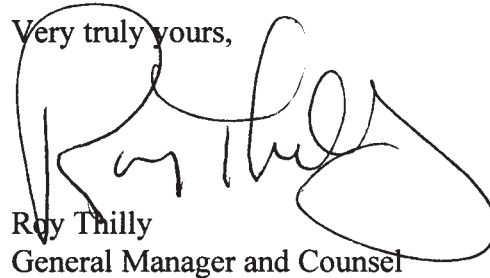
May 13, 1997  
Page Twelve.

**C. Local Distribution Companies (LDC). Should Congress require unbundling of LDC services in order to subject them to competition?**

No. We believe that states should be free to determine how local distribution companies will be regulated -- what Linecos will be able to do and not do. We do not support taking the billing and metering function away from the local distribution company. We believe that the metering function, in particular, is important to reliability and that, while unbundling LDC services may be a step which a state may take in the future, it should not be one of the first steps that is taken in implementing retail competition.

Thank you again for soliciting our views. I hope these comments are helpful in your analysis of this complex subject.

Very truly yours,

A handwritten signature in black ink, appearing to read "Roy Thilly", written over a large, loopy flourish.

Roy Thilly  
General Manager and Counsel

Enclosures

cc: Joe Nipper, APPA  
Deborah Sliz, APCO Associates

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